UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH CAROLINA

In re, Labsource, LLC, Debtor(s).	C/A No. 19-05161-HB Adv. Pro. No. 21-80032-HB Chapter 7
John K Fort, Plaintiff(s), v. Luxor Scientific, LLC; Luxor Solutions, LLC; LS Acquisitions, LLC; and Innovative Scientific Solutions, LLC, Defendant(s).	**ORDER DENYING MOTION TO DISMISS**

THIS MATTER is before the Court for consideration of the Motion to Dismiss filed by Defendant Luxor Scientific, LLC, Luxor Solutions, LLC, LS Acquisitions, LLC, and Innovative Scientific Solutions, LLC (collectively, "Luxor").[1] In this action, Plaintiff John K. Fort, as Trustee for Debtor Labsource, LLC, seeks to avoid a transfer pursuant to 11 U.S.C. § 548(a)(1)(A) and (B) and to recover the transfer or its value pursuant to § 550. Luxor asserts anything of value transferred was fully encumbered resulting in no harm to the estate or its creditors and as a result, the Trustee lacks standing and fails to state a claim, requiring dismissal under Fed. R. Civ. P. 12(b)(1) and (6).[2] Luxor also asserts alternative grounds for dismissal under Fed. R. 12(b)(6). The Trustee filed an Objection.[3]

[1] ECF Nos. 6 & 7, filed Jul. 23, 2021.
[2] Made applicable to this adversary proceeding pursuant to Fed. R. Bankr. P. 7012.
[3] ECF No. 11, filed Aug. 11, 2021.

STANDARD OF REVIEW

Generally, Fed. R. Civ. P. 12(b)(1) "authorizes dismissal of a complaint for lack of jurisdiction over the subject matter, or if the plaintiff lacks standing to bring his claim." *Harrison v. Soroof Int'l, Inc.*, 320 F. Supp. 3d 602, 610 (D. Del. 2018) (quoting *Arneault v. Diamondhead Casino Corp.*, 277 F. Supp. 3d 671, 674-75 (D. Del. 2017)). "A defendant may challenge subject-matter jurisdiction in one of two ways: facially or factually." *Beck v. McDonald*, 848 F.3d 262, 270 (4th Cir. 2017) (citation omitted). "In a facial challenge, the defendant contends that a complaint simply fails to allege facts upon which subject matter jurisdiction can be based." *Id.* (quotation marks and citations omitted). The plaintiff "is afforded the same procedural protection as she would receive under a Rule 12(b)(6) consideration . . ." *Id.* (quotation marks and citations omitted).

A motion filed under Rule 12(b)(6) challenges the legal sufficiency of the complaint and provides that a party may move to dismiss for failure to state a claim upon which relief can be granted. "A motion to dismiss under Rule 12(b)(6) . . . does not resolve contests surrounding the facts, the merits of a claim, or the applicability of defenses." *Republican Party of N.C. v. Martin*, 980 F.2d 943, 952 (4th Cir. 1992). Instead, the Court's inquiry "is limited to whether the allegations constitute a short and plain statement of the claim showing that the pleader is entitled to relief." *Id*. (internal quotation marks and citation omitted). In deciding a motion to dismiss, the Court must draw all reasonable factual inferences in favor of the plaintiff. *Priority Auto Grp., Inc. v. Ford Motor Co.*, 757 F.3d 137, 139 (4th Cir. 2014).

"[F]raud claims . . . must be pleaded with particularity pursuant to Rule 9(b) of the Federal Rules of Civil Procedure." *U.S. ex rel. Nathan v. Takeda Pharm. N. Am., Inc.*, 707 F.3d 451, 455-56 (4th Cir. 2013) *cert. denied*, 134 S. Ct. 1759 (2014) (citing *Harrison v. Westinghouse Savannah*

River Co., 176 F.3d 776, 783-85 (4th Cir. 1999)). "In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally." Fed. R. Civ. P. 9(b). "To meet this standard, [a] plaintiff must, at minimum, describe 'the time, place, and contents of the false representations as well as the identity of the person making the misrepresentation and what he obtained thereby.'" *U.S. ex rel. Wilson v. Kellogg Brown & Root, Inc.*, 525 F.3d 370, 379 (4th Cir. 2008) (quoting *Harrison*, 176 F.3d at 784 (4th Cir. 1999)).

Luxor's assertion that the Trustee lacks standing because anything of value transferred prepetition was fully encumbered and, therefore, the transfer did not harm or prejudice the estate, is a facial attack. Luxor also seeks to dismiss pursuant to Fed. R. Civ. P. 12(b)(6). As a result, the Court will only consider the factual allegations of the Trustee's Complaint.

SUMMARY OF ALLEGATIONS OF THE COMPLAINT

While the Complaint provides background allegations regarding Labsource's formation, operation, and ultimate demise, this action amounts to an alleged fraudulent transfer the Trustee seeks to avoid and recover for the benefit of the estate. The following is a summary of allegations relevant for this Motion.[4]

Oaktree Medical Centre ("OMC") was a pain management practice privately and solely owned by a non-practicing chiropractor, Daniel McCollum. OMC also operated a compounding pharmacy and three toxicology labs, including Labsource – an independent reference lab that offered comprehensive toxicology reporting to healthcare providers. In 2018, approximately 60%

[4] Pursuant to the applicable standards under Fed. R. Civ. P. 12(b)(1) and (6), the Court must accept as true all the facts alleged in the Complaint and construe all reasonable inferences in favor of the Trustee. *E.I. du Pont de Nemours and Co. v. Kolon Indus., Inc.*, 637 F.3d 435, 440 (4th Cir. 2011).

of Labsource's lab sample receipts were from OMC's clinics, with the remaining 40% from third-party sources. In 2018, Labsource processed approximately 92,413 samples in total.

In 2014, Fidus Investment Corporation and West Family Investments (collectively the "Lenders") provided OMC with a $14.0 million senior secured credit facility to finance OMC's acquisition of another healthcare practice. On or around 2017, the Lenders added Labsource as a borrower to the investment agreement because OMC violated a covenant of that agreement by spending approximately $6.0 million to start Labsource without their consent. In 2018, after OMC failed to repay the Lenders on the maturity date, the Lenders exercised one of their remedies and terminated McCollum's rights to exercise control over OMC, including Labsource. The Lenders also appointed an independent director/manager at Labsource and vested him with corporate authority and control over its day-to-day management, financials, and operations. Around late July 2018, other professionals were hired to assist with the corporate restructuring necessary to refinance the Lenders' loan and a Chief Restructuring Officer was hired in November 2018.

By April 2019, OMC borrowed additional amounts from Lenders exceeding $5 million to pay its professional fees and interest on prior loans. As late as July 2019, the professionals were still attempting to complete a financial projection and business plan to support a restructuring proposal but needed additional funds from the Lenders to pay themselves and expand their team. Although the Lenders approved an additional $1 million loan to effectuate the restructuring, the professionals changed course and advised that a Chapter 11 bankruptcy was necessary and required almost $5 million in additional funding. Once the Lenders declined to increase their commitment, Chapter 7 preparations began.

Pursuant to an Asset Purchase Agreement between Labsource and LS Acquisition, Luxor paid $350,000.00 for Labsource's equipment. The Trustee asserts Luxor actually received the entirety of Labsource's operations, including all active lab collector employees, all clinical operations, IT services, computers, email addresses, domain name, uninterruptable power supplies, and a transport van (the "Transfer"). He also alleges LS Acquisition is a shell company set up solely for this Asset Purchase Agreement and Luxor received the benefit of the Transfer. The Complaint does not allege the date of the Transfer, other than it was after the July 2019 decision to liquidate Labsource and before September 19, 2019, when the Chief Restructuring Officer filed a petition for Chapter 7 relief on behalf of Labsource.

Sometime post-petition, the Trustee's expert determined the value of Labsource's third-party testing business was $5,240,000.00 at the time of the Transfer, and the equipment subject to the Asset Purchase Agreement was worth more than $550,000.00. The Trustee asserts the liquidation process under the professionals' control was a forced fire sale under arbitrarily severe time constraints based solely on how much was available to pay professional fees. He alleges the Chief Restructuring Officer and his team made no effort to sell Labsource as a going concern, despite 40% of its revenue coming from third-party tests. He claims the professionals declined Luxor's offer for a percentage of revenue in exchange for Labsource's book of business because payments over time would not benefit the professionals. The professionals did not obtain or attempt to obtain Labsource's true market value and the only effort to value Labsource's "hard assets" was to seek assessments from employees involved in the purchasing and selling of the equipment. The Complaint asserts Luxor had direct knowledge of the benefit it received in acquiring Labsource's operations at no cost and was able to maximize its windfall to the detriment of Labsource's creditors.

The Trustee alleges Labsource received less than reasonably equivalent value in connection with the Transfer and was insolvent at the time of the Transfer. The Trustee also asserts the

Transfer was made with the actual intent to hinder, delay, or defraud Labsource's creditors as evidenced by, *inter alia*, failing to appropriately value the property transferred and/or accept the percentage of revenue offer from Luxor, and having the singular motive of realizing just enough proceeds to pay professional fees. The Trustee seeks recovery of the transfer or its value pursuant to §§ 548(a)(1)(A), (B) and 550.

APPLICABLE AUTHORITIES

Section 548 allows the trustee to avoid fraudulent transfers of an interest of the debtor in property incurred within 2 years before the date of the filing of the petition. 11 U.S.C. § 548(a)(1). Such transfers may be founded on actual fraud or constructive fraud. Under § 548(a)(1)(A), a transfer is avoidable if it was actually fraudulent in that it was made "with actual intent to hinder, delay, or defraud any entity to which the debtor was . . . indebted[.] Under § 548(a)(1)(B), a transfer is avoidable as constructively fraudulent if the debtor "received less than a reasonably equivalent value in exchange for such transfer . . . and . . . was insolvent on the date that such transfer was made . . ."

Section 550(a) of the Code is a remedies section and defines the party from whom a trustee may seek to recover property that is fraudulently transferred or the value or proceeds of such property. Section 550(a) requires the Trustee to establish that the transfer was "avoided under Section 544, 545, 547, 548, 549, 553(b), or 724(a) . . ." 11 U.S.C. § 550(a). Once the transfer is avoided, the trustee may pursue the actual recovery of the transfer from the initial transferee, the entity for whose benefit such transfer was made, or an immediate or mediate transferee. 11 U.S.C. § 550(a)(1) & (a)(2); *In re Allou Distribs., Inc.*, 379 B.R. 5, 19 (Bankr. E.D.N.Y. 2007) (citations omitted).

Luxor asserts the entire Complaint should be dismissed under Fed. R. Civ. P. 12(b)(1), arguing the Trustee lacks standing because there is no injury or prejudice to Labsource's estate since anything of value transferred was subject to the Lenders' security interests. In support of this argument, Luxor relies on *In re All Phase Roofing and Constr., LLC*, 2020 WL 374357 (Bankr. W.D. Okla. Jan. 17, 2020), *aff'd*, 2020 WL 5512500 (B.A.P. 10th Cir. Sept. 14, 2020). In that case, a trial was conducted on the Chapter 7 trustee's numerous causes of action, including avoidance claims under §§ 548 and 550. In analyzing the claim for constructive fraud under § 548(a)(1)(B), the court stated:

> Courts conduct a two-prong analysis to determine whether a debtor has received reasonably equivalent value in exchange for its transfer of an interest in its property to another. First, courts question whether the debtor received value; second, courts question whether that value was reasonably equivalent to what the debtor gave up.

Id. at *12 (internal quotation marks and citations omitted). Although that debtor received no consideration from the recipient of the transfer at issue, the court reasoned it was also required to measure the value of what the debtor received (i.e., nothing) against the value of what it transferred. "This inquiry necessarily focuses on whether or not [the debtor]'s unsecured creditors were better off before or after the transfers, i.e., whether the transferred property actually had value that can be recovered for the benefit of the estate." *Id.* Because the property transferred was subject to liens of creditors in excess of the value of the property transferred, the court found it had no value to the estate and the unsecured creditors were no worse off after the transfer. *Id.* at *13. "[I]t is not possible to receive less than reasonably equivalent value for an asset that has no value." *Id.* (citations omitted). Therefore, the trustee failed to establish a constructively fraudulent transfer under § 548(a)(1)(B).

The *All Phase Roofing* court also found the trustee established a claim to avoid a fraudulent transfer under § 548(a)(1)(A) but its recovery under § 550 was similarly precluded. "[B]ecause

Section 550 requires recovery to be for the benefit of the estate, '[a]voidance is always necessary for recovery, but recovery is not always necessary or even useful after avoidance.'" *Id.* at *16 (quoting *Barber v. McCord Auto Supply, Inc. (In re Pearson Indus., Inc.)*, 178 B.R. 753, 759 (Bankr. C.D. Ill. 1995)). "Instead, '[t]he proper focus of recovery under Section 550(a) is not on what the transferee gained but rather on what the bankruptcy estate lost as a result of the transfer.'" *Id.* (quoting *Rushton v. Bank of Utah (In re C.W. Mining Co.*), 477 B.R. 176, 185 (10th Cir. 2010), *aff'd* 749 F.3d 895 (10th Cir. 2014)). The court concluded the avoided transfer was not "useful" because the trustee did not establish that the transferred property had value in excess of liens for the estate to benefit from its recovery. *Id.* at *16-17.

Luxor also argues the Trustee fails to state a claim for relief under Fed. R. Civ. P. 12(b)(6) because the actual fraud claim under § 548(a)(1)(A) is not pled with particularity and the allegations for recovery of a constructively fraudulent transfer under § 548(a)(1)(B) are vague and conclusory.

CONCLUSION

Luxor's Motion includes facts outside the Complaint and requests the Court consider and weigh the facts in order to dismiss the Trustee's action, which is premature under Fed. R. Civ. P. 12(b)(6) and facial challenges to subject matter jurisdiction under Fed. R. Civ. P. 12(b)(1). The *All Phase Roofing* case was decided after a trial on the merits and a weighing of the evidence such that relevant lien amounts, the relative values of what the estate lost, and the benefit (or lack thereof) to the estate were established. While the issue raised by Luxor and demonstrated in *All Phase Roofing* may prove relevant in this adversary proceeding, it is not dispositive at this stage. The Complaint is sufficient to state a claim and Luxor's Motion to Dismiss all causes of action based on this argument pursuant to Fed. R. Civ. P. 12(b)(1) and/or (6) is denied.

The allegations of the Trustee's Complaint identify the transfer in question, the Trustee's purported value of the Transfer compared to the actual consideration received, and Labsource's insolvency at that time to state a claim under § 548(a)(1)(B). Although the cause of action under § 548(a)(1)(A) is directed mostly at the Chief Restructuring Officer and professionals for OMC and Labsource in failing to negotiate or attempt to obtain a better purchase of Labsource, it asserts there was a singular motive among them and Luxor to reach a sales price sufficient to only pay the professionals' fees. A review of the Complaint indicates it sets forth sufficient factual allegations notifying Luxor of the claim asserted against it and that dismissal pursuant to Fed. R. Civ. P. 12(b)(6) is not warranted.

IT IS, THEREFORE, ORDERED that Luxor's Motion to Dismiss is denied. Pursuant to Fed. R. Bankr. P. 7012, Luxor shall file and answer to the Complaint within fourteen (14) days from entry of this Order.

AND IT IS SO ORDERED.

FILED BY THE COURT
09/13/2021

Entered: 09/13/2021

Chief US Bankruptcy Judge
District of South Carolina